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Developments in Installment Payment of Federal Estate Tax

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Issue Contents

Bankruptcy

Federal Tax

Discharge **51**

Sale of Chapter 12 estate property **51**

Federal Agricultural Programs

Country-of-origin labeling **51**

Meat inspection **51**

Tuberculosis **51**

Federal Estate and Gift Taxation

Gross estate **51**

Marital deduction **51**

Federal Income Taxation

Business expenses **52**

Corporations

Officer compensation **52**

Dependents **52**

Disability access credit **52**

Disaster losses **52**

Education expenses **53**

First-time homebuyer credit **53**

Gambling expenses **53**

IRA **53**

Innocent spouse **53**

Internal Revenue Service **53**

Like-kind exchanges **53**

Limited liability companies **53**

Mortgage interest deduction **53**

Net operating losses **54**

Partnerships

Administrative adjustment **54**

Passive activity losses **54**

Penalties **54**

Pension plans **54**

S Corporations

Second class of stock **55**

Safe harbor interest rates

April 2009 **55**

Taxpayer advocacy panel **55**

Travel expenses **55**

Trusts **55**

Unemployment benefits **55**

Negligence

Assumption of risk **55**

In the News

Farm programs **55**

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Developments in Installment Payment of Federal Estate Tax

-by Neil E. Harl*

With the strong likelihood that the federal estate tax will not be repealed at the end of 2009,¹ and that the tax will almost certainly survive into 2010 and beyond, attention is being refocused on ways to manage federal estate tax liability in larger estates.² The level of the applicable exclusion amount³ which is expected to be in effect for 2010 and beyond means that the federal estate tax is unlikely to affect most farm and ranch operations.

One of the useful tools for managing federal estate tax liability attributable to eligible closely-held businesses is the election available to pay that portion of the federal estate tax in installments over nearly 15-years after death.⁴ Two recent developments, published on the same date,⁵ provide additional guidance on the election under that provision and on the handling of security after death to assure that the tax will be paid.⁶

The advantage of installment payment

For deaths since 1997, interest at two percent has been imposed on the amount of deferred federal estate tax under the nearly 15 year deferral⁷ on an inflation adjusted amount above the applicable exclusion amount.⁸ For deaths in 2009, the applicable exclusion amount is \$3,500,000 per decedent⁹ and the inflation adjusted amount for the "two percent portion" is \$1,330,000.¹⁰ Thus, the amount eligible for the payment of two percent interest is the federal estate tax attributable to a closely-held business between \$3,500,000 and \$4,830,000. For an estate holding an interest in a closely-held business of \$4,830,000, the two-percent portion would be \$598,500 (the \$2,054,300 estate tax on \$4,830,000, minus \$1,455,800, the tax on the applicable exclusion amount for 2009).

The interest rate imposed on the amount of deferred estate tax attributable to the taxable value of a closely-held business in excess of \$1,330,000 (above the applicable exclusion amount of \$3,500,000) is 45 percent of the rate applicable to underpayments of federal estate tax.¹¹ The rate for underpayments of tax is published on a quarterly basis¹² and is based on the federal short term rate with daily compounding.¹³ For the period of April 1, 2009 through June 30, 2009, the rate is four percent.¹⁴ Therefore, for the second quarter of 2009, the rate would be 45 percent times five percent or 1.8 percent.

Paying deficiencies in installments

A feature of installment payment of federal estate tax which is less well known is that an election may be made to pay deficiencies in installments even if an installment payment election has not been made.¹⁵ Deficiencies may be paid in installments even though the federal estate tax return was not timely filed unless the deficiency was due to negligence, intentional disregard of the rules and regulations or fraud.¹⁶ Although deficiencies may be paid on an installment basis, even with a late-filed return and no installment payment

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election made, an estate may not elect installment payment of estate tax (after assessment of a deficiency) for the entire amount that would have been claimable where no election to pay estate tax in installments was made with a timely-filed return.¹⁷

The election to pay deficiencies in installments is to be made not later than 60 days after issuance of notice and demand by the Internal Revenue Service for payment of the deficiency.¹⁸ In a 1994 case,¹⁹ it was no excuse that IRS mailed the notice of deficiency to the wrong address. The taxpayers still had 34 days remaining to file the election and failed to elect in a timely manner.

Maximum security for the lien

An estate representative seeking discharge from liability may file an agreement giving rise to a special estate tax lien²⁰ or by posting a bond.²¹ In 2007, the Tax Court held that I.R.C. § 6166 does not require a bond or lien in every case and rejected the IRS bright-line test of a surety bond as an abuse of discretion.²² Later, in 2007, IRS announced that, in light of the Tax Court decision,²³ the agency would determine on a case-by-case basis whether security would be required when an estate elects to pay the federal estate tax in installments.²⁴ The non-exclusive list of factors to be considered include – (1) duration and stability of the business; (2) ability to pay the installments of tax and interest in a timely fashion; and (3) the compliance history of the business.²⁵

The maximum amount of property subject to the lien is the amount of deferred tax plus the first four years of interest.²⁶

In late 2008, the Chief Counsel's Office of IRS ruled²⁷ that, if using the flat two percent interest rate results in an amount that is less than or equal to 45 percent of the underpayment interest rate, "... it is legally permissible."²⁸ The CCA letter ruling also stresses that the discussion is of the maximum and IRS should use its judgment in determining the amount of collateral to require to protect the Government's interest.²⁹

Endnotes

¹ Economic Growth and Tax Relief and Reconciliation Act of 2001, Pub. L. No. 107-16, § 511, 115 Stat. 38 (2001).

² See Harl, "Does the Federal Estate Tax Jeopardize Farm and Ranch Businesses?" 16 *Agric. L. Dig.* 113 (2005); Harl, "Federal Estate Taxation of Farm and Ranch Estates," 14 *Agric. L. Dig.* 153 (2003). See generally 5 Harl, *Agricultural Law* Chs. 42, 43 (2009); Harl, *Agricultural Law Manual* Ch. 5 (2009).

³ I.R.C. § 2010(c).

⁴ I.R.C. § 6166.

⁵ The rulings were published on March 2, 2009.

⁶ CCA Ltr. Rul. 200909047, Dec. 4, 2009 (paying deficiencies in installments); CCA Ltr. Rul. 200909044, Dec. 2, 2008 (calculating the maximum security that can be required to secure payment of the deferred federal estate tax).

⁷ I.R.C. § 6166.

⁸ I.R.C. § 2010(c).

⁹ *Id.*

¹⁰ Rev. Proc. 2008-66, § 3.37, 2008-2 C.B. 1107.

¹¹ I.R.C. § 6601(j).

¹² I.R.C. § 6621.

¹³ Notice 88-59, 1988-1 C.B. 546.

¹⁴ Rev. Rul. 2009-7 2009-1 C.B. ____.

¹⁵ I.R.C. § 6166(h).

¹⁶ CCA Ltr. Rul. 200909047, Dec. 4, 2008; Ltr. Rul. 8432007, April 9, 1984.

¹⁷ Ltr. Rul. 8846001, July 27, 1988.

¹⁸ I.R.C. § 6166(h)(2).

¹⁹ *Bauersfeld v. United States*, 94-2 U.S. Tax Cas. (CCH) ¶ 60,182 (D. Kan. 1994).

²⁰ I.R.C. § 6324A.

²¹ I.R.C. § 6165.

²² *Estate of Roski, Sr. v. Comm'r*, 128 T.C. 113 (2007) (estate had difficulty in obtaining a bond for the time period involved).

²³ *Id.*

²⁴ Notice 2007-90, 2007-2 C.B. 1003.

²⁵ *Id.*

²⁶ I.R.C. § 6324A(e)(1), (2).

²⁷ CCA Ltr. Rul. 200909044, Dec. 2, 2008.

²⁸ *Id.*

²⁹ *Id.*

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